IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 305

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

v.

NEW ENGLAND ELECTRIC SYSTEM ET AL.,
Respondents.

ON A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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OPINION BELOW

The opinion of the Court of Appeals for the First Circuit on the judgment sought to be reviewed is reported at 376 F.2d 107.

QUESTION PRESENTED

The "basic question" stated in the Petition — whether the court below misapprehended the standard laid down by this Court for interpreting the "substantial economies" test under Section 11(b)(1)(A) of the Holding Company Act,[1] and improperly shifted the burden of proof from the holding company to the Commission (Pet. 2)[2] — is not raised by the record. The Petition in no way questions the standard of "serious impairment" as stated by this Court and the court below, and there is now no definitional dispute. As to the application of this standard and the burden of proof, the

[1] Public Utility Holding Company Act of 1935, 49 Stat. 820 (1935), 15 U.S.C. §79k(b)(1)(A) (1964).

[2] "Pet." refers to the Petition of the Securities and Exchange Commission including its appendices which reproduce the opinions of the court below and the Commission's Findings and Opinion.

court below explicitly stated that the holding company has the burden of proving loss of substantial economies under a stringent standard (Pet. 22); and nothing in its opinion even suggests that the burden of proof should be shifted from the holding company to the Commission.

The Petition also states three subsidiary "specific questions" as facets of the "basic" question (Pet. 3). None of these (as more fully discussed at pages 10-12 below) appears to be raised by the record or to be appropriate for consideration by the Court at this time.

The Respondents[3] say that the basic issue in the case is whether the court below, after review of the entire record, correctly held that the Commission in its Findings and Opinion has not indicated that it has adequately examined the evidence and applied its expertise to the particular facts and circumstances disclosed thereby and has not adequately stated its reasoning and conclusions.

STATEMENT OF THE CASE

The Respondents are dissatisfied with the Petition's "Statement" (Pet. 4) in the following respects:

1. The Statement omits the crucial holding of the court below, based on its review of the entire record, as to the quality of the Commission's analysis of the evidence and its use of expertise in this case:

> "Even without the burden of proving likely demise,[4] petitioner's [NEES'] burden is, as the Court said, to meet

[3] The Respondents are New England Electric System ("NEES") and subsidiaries.

[4] The Commission took a position before the Court of Appeals which indicated that it understood that the test of "loss of substantial economies" would be met only if the separated system would be "unable to stand by itself" (Pet. 20-21, 38). The court below carefully analyzed and then rejected this position, stating that a test based on mere ability to survive would read out of the Act the phrase "without the loss of substantial economies", and would distort this Court's approval of the words "serious impairment" (Pet. 21-22). The Petition does not take issue with that conclusion.

'a much more stringent test' than that of a probable significant loss. But, if the standard to be applied to petitioner is stringent, so is the level of analysis and expertise to be exercised by the Commission. We have, only after a fresh review of all the evidence in the light of this most stringent practical standard,[5] concluded that the Commission's opinion does not reveal that application of both reason and experience to facts which merits endorsement as the responsible exercise of expertise." (Pet. 22).

2. The Statement omits the circuit court's reasons for its holding that the Commission erred in its rejection of the entire Ebasco Report (a study of the effects of severance prepared by Ebasco Services, Inc.) and in its related conclusion that no losses had been proved. The court's reasons were the following:

(i) Even though, as the Petition notes (Pet. 6), the court did "not necessarily criticize the Commission for its skepticism in the specifics" (Pet. 24), it nonetheless concluded that "even taken together these items [the Commission's reasons for rejection] constitute at most a basis for reducing the estimated figure by some amount, not for concluding that no increased costs have been proved" (Pet. 24); and

(ii) "In fact, the record here demonstrates conclusively that *some* increased costs are inevitable — the only doubt possible concerns the amount." (Pet. 24). This conclusion the Petition apparently does not challenge.

3. The Statement makes no mention of the Commission's alternative reliance (assuming the losses were proved) on precedents and ratios taken without analysis from other cases, nor of the court's careful exposition of the very limited relevance of those precedents and ratios and of the

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[5] The words "most stringent" are italicized in the Petition's reproduction of the court's opinion (Pet. 22) but are not italicized in the report. See 376 F.2d at 111.

Commission's failure to evaluate their comparability or meaning in this case (Pet. 29, 31). The court said that it did not "think that the Commission's obligation, which is at the root of the respect to which its expertise is entitled, is satisfied by the invocation of largely irrelevant ratios or other data concerning other companies, at other times, in other areas, facing possibly different conditions." (Pet. 31). The Commission's error, the court below said, was its failure to evaluate the effect of the anticipated losses "on the economic health of the particular [NEES] companies involved, in their particular circumstances." (Pet. 30).

4. The Petition states that the Commission found that other gas systems in Massachusetts "operate profitably" (Pet. 7), and says moreover that they are "thriving" (Pet. 11). The Findings and Opinion has no such finding. The closest the Commission came to suggesting successful operation was to say that other gas utility companies in Massachusetts "have been *able to conduct* their operations and, *apparently,* earn a fair return. . . ." (Pet. 59. Emphasis added.) The evidence in the record made it abundantly clear that all gas distribution companies in Massachusetts are remote from their source of supply and are in heavy competition with oil (Pet. 25). The court stated that:

> ". . . we can only conclude on the present record that all gas in New England operates on, as one witness testified, a small cushion. The significance of this is not negated by observing that non-NEES companies in Massachusetts seem to be surviving, for the focus must be on the specific characteristics of the NEES companies, the only ones affected by the Commission's order." (Pet. 27-28).

5. The court below did not hold, as the Statement suggests it did (Pet. 7), that the Commission had to determine whether the projected rate of return of the NEES gas companies operating independently would be sufficient to attract

the new investment necessary for the system's survival and growth. The court, "without pretending to define the one true test" (Pet. 30), listed that as one of several important economic considerations which it thought might be relevant factors for the Commission to consider when applying its expertise to determine the impact the losses would have on the particular companies involved (Pet. 30-31). In this connection the court pointed out that the Commission had failed even to discuss the fact that the projected rate of return for the NEES gas companies would be significantly below the average of the independent companies' "apparently fair" rate of return (Pet. 29), and also that the Commission's comparison of operating ratios (the ratio of costs to revenues cited by the Statement (Pet. 7)) is "irrelevant" (Pet. 30 n.6).

6. The Petition makes no reference to the holding of the court below that the burden of persuasion to which the holding Company may properly be held by the Commission is "a fair preponderance of the evidence" rather than a special standard of "clear and convincing evidence" of the kind traditionally imposed in civil cases involving such matters as fraud, and also in denaturalization and expatriation cases, and, more recently, deportation proceedings (Pet. 24 n.3, 77 n.4).[6] The Petition does not raise this issue and presumably accepts the ruling of the court below.

7. The Statement overstates the scope of the ruling of the court below with respect to the weight to be attributed by the Commission to the possibility of benefits from increased competition between gas and electricity. The court below held that the likelihood of such benefits "is precisely the sort of empirical judgment that the Commission is best qualified to make in light of its expertise" (Pet. 33), and it read this Court's opinion as saying that the Commission may "take that judgment into account as justifying a stringent test of

[6] See Woodby v. Immigration & Naturalization Serv., 385 U.S. 276, 285 n. 18 (1966); McCormack, Evidence § 320 (1954).

'substantiality'." (Pet. 33). The court then said that having established that stringent standard, unless it finds (as it has in a significant number of other divestment cases[7]) that the company to be divested has been suppressed for the benefit of its affiliates or that some definable particularized benefit will accrue from divestment, the Commission should confine itself to a quantitative analysis of the substantiality of the proved losses (Pet. 33-34). Since the Commission had found neither suppression nor any particularized offsetting benefit to be gained from severance, the court concluded that the Commission was "improperly attributing independent significance to the generalized competitive advantages" (Pet. 34). Were the Commission not required to make supporting findings, its judgment would be "unreviewable" (Pet. 32). That, the court concluded, was not this Court's intent (Pet. 32-33).

ARGUMENT

1. In its present posture, this case involves numerous evidentiary and factual questions and is not appropriate for the Court's review.

The important legal question presented by this case has already been decided by the Court. 384 U.S. 176 (1966). What remains involves evidentiary and factual questions which would require the examination of thousands of pages of testimony and exhibits, and which because of the lack of essential findings and statement of reasons by the Commission could not be finally resolved by the Court on the basis of the record as it now stands.

Following the remand from this Court, the court below carefully reexamined the entire record and concluded that the Commission had not adequately examined the evidence

[7] Engineers Pub. Serv. Co., 12 S.E.C. 41, 58 (1942) (abuses in expense allocations); Cities Serv. Power & Light Co., 14 S.E.C. 28, 66 (1943) (neglect); North American Co., 18 S.E.C. 611, 620-21 (1945) (electric expansion at expense of gas); Commonwealth & Southern Corp., 26 S.E.C. 464, 490 (1947) (suppression of gas).

and applied its expertise, and had not adequately stated its reasoning and conclusions. The court found, for example, that the Commission's rejection of the Ebasco Report was contrary to conclusive evidence in the record (Pet. 24); that the Commission's Findings and Opinion failed even to discuss "obviously important data" (Pet. 29); and that the Commission relied instead on "the invocation of largely irrelevant ratios or of other data concerning other companies, at other times, in other areas, facing possibly different conditions." (Pet. 31).

Such a review of the record and testing of the Commission's findings in light of the substantial evidence in that record, taken as a whole, is precisely the function of judicial review which this Court and the Administrative Procedure Act have directed the Courts of Appeals to perform. "Whether on the record as a whole there is substantial evidence to support agency findings is a question which Congress has placed in the keeping of the Courts of Appeals." *Universal Camera Corp.* v. *NLRB,* 340 U.S. 474, 490-91 (1951). See *FTC* v. *Standard Oil Co.,* 355 U.S. 396, 401 n. 6 (1958); 5 U.S.C. §706 (Supp. II, 1965-66) (Administrative Procedure Act as codified by Public Law 89-554, 80 Stat. 393); Section 24(a) of the Public Utility Holding Company Act of 1935, 49 Stat. 834 (1935), as amended, 15 U.S.C. §79x(a) (1964).

This court does not grant certiorari to review evidence and discuss specific facts, and by its own decisions, its power to review the correctness of the application of the standard of substantial evidence in light of the entire record "ought seldom to be called into action." *Universal Camera Corp.* v. *NLRB, supra* at 490; *United States* v. *Johnston,* 268 U.S. 220, 227 (1925). The Court "will intervene only in what ought to be the rare instance when the standard appears to have been misapprehended or grossly misapplied." *Universal Camera Corp.* v. *NLRB, supra* at 491. This is because the Court, if it does review, will do "no more on the issue of insubstantiality than decide [whether] the Court of Ap-

peals has made a 'fair assessment' of the record." *FTC* v. *Standard Oil Co., supra* at 401.

This case is by no means one for the invocation of the rare and unusual step of this Court's review of the evidence in the entire record. The evidence is lengthy, complex and detailed. It has twice been completely reviewed by the Court of Appeals for the First Circuit.[8] The opinions of that court conclusively demonstrate that it made a fair assessment of the record, and the Petition does not contend otherwise.

2. The court below has not misapprehended this Court's standard nor has it shifted the burden of proof.

As already noted, the Petition does not question the circuit court's affirmation of the "serious impairment" standard laid down by this Court. Nor can it be said, based on the whole record, that the Court of Appeals has misapprehended the standard of substantial evidence. Rather, the court has quite properly required that the findings of the Commission be reasonably consistent with the substantial evidence in the record as a whole as applied to the statutory standard laid down by this Court (Pet. 24-25, 91-94), and sufficiently articulated and particularized to enable the reviewing court to determine whether the Commission has indeed applied its expertise in this case. See *Secretary of Agriculture* v. *United States,* 347 U.S. 645, 653-54 (1954); *Burlington Truck Lines, Inc.* v. *United States,* 371 U.S. 156, 167 (1962); and 5 U.S.C. §557 (Supp. II, 1965-66) (Administrative Procedure Act as codified by Public Law 89-554, 80 Stat. 387).

The basic contention of the Petition appears to be that the court below has required the Commission to bring forward its own evidence with respect to the economies to be lost,

[8] In all, five judges sitting on the Court of Appeals for the First Circuit have now reviewed the record in this case and have all concurred in that court's conclusions.

thereby shifting the burden of proof (Pet. 2, 8-9). This alleged misapprehension on the part of the court below, the Petition states, "inverts the scheme of the Act" (Pet. 9), "resolved all doubts in favor of retention" (Pet. 10, 12), requires the Commission "to remedy the deficiencies in the holding company's proof" (Pet. 10), and will leave the Commission's administrative resources "sorely strained" (Pet. 12).

If this is the contention of the Petition, it is clearly erroneous. The directive of the court below was not that the burden of proof should be shifted to the Commission or that the Commission's staff, which was a party to the hearing, should have adduced additional evidence or indeed any evidence at all. The court's requirement was instead that the Commission itself should adequately analyze, and in its Findings and Opinion adequately state its analysis of, the relevant evidence (Pet. 24-25, 29); that it should "address the considerations relevant to the ultimate issue it is required to resolve" (Pet. 27) and that through reasonably specific findings and conclusions by the Commission there should be "communicated" to the reviewing court the fact that, and the manner in which, the Commission has exercised its expertise (Pet. 31).

This is a normal and necessary standard of administrative practice; it represents the implementation, not the misapprehension, of this Court's opinion. The importance of the care and thoroughness required of the Commission by the court below is emphasized by this Court's standard of "serious impairment." The line is now drawn so close to the point of probable business failure that not only does it make the holding company's burden of proof a difficult one to carry, but it also makes the risk more substantial that a divestment order based on erroneous findings and broad assumptions rather than individual consideration will result in economic disaster (Pet. 27).

3. The Petition's three subsidiary questions are not raised by the record and are not appropriate for review.

The Petition lists three specific questions as facets of the basic question (Pet. 3). The Respondents submit that these questions are not raised by the record and are not appropriate for the Court's review at this time.

(i) The court below did not make the Commission's consideration of benefits of independent operation conditional on a finding of specific dollar value.

The Petition's first specific question is whether the Commission may consider offsetting advantages of independent operation without attempting to fix a specific dollar value therefor (Pet. 3). The Petition implies that the court below answered this question in the negative and thus imposed a requirement impossible to comply with (Pet. 14). What the court actually decided is something quite different.

First, as noted in item 7 at pages 5 and 6 above, the court affirmatively approved the Commission's reliance on its general experience in assuming that some benefits from independence are always likely to be realized, and the Commission's taking that assumption into account, without any quantitative evaluation, in justifying a stringent test of "substantiality" (Pet. 33).

Second, the court noted that the Commission had made no finding of offsetting advantages in this particular case (Pet. 33), but had instead apparently offset the proved losses on the basis of "generalized competitive advantages" (Pet. 34). While holding that the general conclusion can have no independent significance in an individual case, the court took pains to provide for any case in which the Commission finds a specific identifiable benefit of separation (Pet. 33, 94). In such a case, there is nothing in the court's opinion which requires, as the Petition suggests (Pet. 3, 14),

that the Commission attempt "to fix a specific dollar value" (Pet. 3); its obligation is rather, as the court said, to establish "its best estimate" (Pet. 30). The defect in the Commission's treatment of anticipated benefits of separation was, in the court's view, "the Commission's failure to find or articulate any specific or approximate financial benefit that such a change would occasion" (Pet. 94).

Unless the Commission is held to a reasonable standard of analysis, evaluation and articulation with respect to the benefits of competition in the particular case, proved losses of economies, however large, could be offset on the basis of an unexplained and unsupported statement that they are outweighed by the possible advantages of increased competition. This would give the Commission *carte blanche* arbitrarily to order divestment in any case it so desires, and as the court below noted, would make its judgment as a practical matter "unreviewable" (Pet. 32).

(ii) The court correctly found that the Commission's rejection of the Ebasco severance study in its entirety was based on insufficient reasons and was contrary to conclusive evidence in the record.

The Petition's second specific question is whether the court below properly held that the Commission erred in rejecting the Ebasco Report in its entirety (Pet. 3). The Petition assumes that the alleged deficiencies found in the Report by the Commission were "serious" (Pet. 3). The court below, however, found that they related at most to a relatively small part of the losses (Pet. 92), and were in any event an insufficient basis for total rejection, and held that the record showed conclusively that some losses were inevitable (Pet. 24). This difference is precisely the kind of evidentiary question involving a careful review of the record and evaluation of administrative findings which this Court has traditionally entrusted to the courts of appeals. It is more fully discussed under item 4 at page 12 below.

(iii) The court did not require the Commission to make a specific determination of the future rate of return.

The Petition's third specific question is based on the assumption that the Commission found "that the separated [gas] system would have an adequate margin of revenue over costs for successful independent operation", and suggests that the court improperly required the Commission to make "a specific determination as to the system's future rate of return" (Pet. 3, 10). The Commission did not make the assumed finding, and the court did not require the specified determination.

What in fact the court did was to require the Commission to address itself to a prediction of the effect of the estimated losses on the economic health of the particular companies involved in their particular circumstances (Pet. 30). It specifically disclaimed any intention to define any one test, but suggested that a proper analysis and application of the statutory standard to the evidence by the Commission *might* involve consideration of such relevant factors as the effect of the losses on new equity financing, the effect of reduction of rate of return on investment, the effect of the losses on the cost of borrowing money and, if rate increases seemed probable, whether the effect would be to "injure deeply, hurt slightly, or affect not at all the companies' ability to survive" (Pet. 30-31). As the court noted, "The Commission considered none of these." (Pet. 31).

4. The holding of the court below on the Ebasco Report was correct.

The Ebasco Report dealt with all facets of the NEES operation and projected in detail the estimated losses which would result from severance. The Ebasco personnel responsible for preparation of the Report were duly qualified

as experts and testified as witnesses on both direct and cross examination. The Chairman of the Massachusetts Department of Public Utilities as well as executive officers of NEES, all of whom concurred in the Report's conclusions, were also so qualified and so testified. At no time has the Commission or its staff even suggested that any of the expert witnesses involved was not qualified or that the sincerity or veracity of any was in any way in doubt. (See Pet. 50.) Indeed, as the court below pointed out, the Commission demonstrated its confidence in the Ebasco Report by accepting its cost estimates for other purposes in this same case (Pet. 24, 94).[9]

In support of its divestment order, the Commission found (as an alternative holding) that the credibility of that portion of the Ebasco Report which stated the estimated increases in treasury and accounting costs amounting to $472,100 (approximately 40% of the total estimated annual losses), had been substantially impaired and could not be believed, and accordingly that the entire Report was to be rejected (Pet. 55). The Commission based this conclusion on (i) Ebasco's alleged failure to consider use of combined customer billing and (ii) alleged disparities in the allocation of certain accounting expenses of the gas and electric companies at Northampton and Lynn, Massachusetts (Pet. 52-55).

The first ground for rejection was apparently based on an obvious mistake of fact: Ebasco had carefully considered the use of combined billing and rejected it, as noted by the court below in its first review of the Commission's Findings and Opinion (Pet. 90-91). Furthermore, with respect to the first ground for rejection, the court below pointed out that customer billing constituted a small portion of customer accounting (in turn part of the $472,100 total treasury and

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[9] The court has incorporated in its second opinion its comments on the evidentiary questions stated in its first opinion (Pet. 24).

accounting figure), and that even if combined customer billing were used, as the Commission suggested, the saving would result, at most, in a partial reduction in the approximately $60,000 which the court estimated as the amount of the increased customer billing expense (Pet. 92). With respect to the second ground for rejection, the alleged disparity, the court below noted that the Commission had not contended that many sizeable items attributable to the disparity would be removed from the $472,100 cost estimate (Pet. 92). The court concluded that on the record even at minimum the losses from severance were "$1,098,000 minus some fraction of $472,000" (Pet. 94). It held in consequence that:

> ". . . these items [the Commission's criticisms as to combined billing and disparate treatment] constitute at most a basis for reducing the estimated figure by some amount, not for concluding that no increased costs have been proved. In fact, the record here demonstrates conclusively that *some* increased costs are inevitable — the only doubt possible concerns the amount." (Pet. 24).[10]

In the absence of conscious falsehood, the doctrine of *"falsus in uno, falsus in omnibus"* does not ordinarily apply, and an expert's report may ordinarily be impeached only if his alleged errors are directly related to the other aspects of his testimony or are of so substantial a nature as to indicate carelessness or otherwise cast doubt on his qualifications. See *Hoag* v. *Wright*, 174 N.Y. 36, 43, 66 N.E. 579, 581

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[10] The court continued by saying that the Commission should "attempt to determine some acceptable figure" and establish "its best estimate of the extent of the definable losses likely to result" in order to assess their impact on the economic health of the companies involved (Pet. 25, 30). Contrary to the Petition's suggestion (Pet. 10, 12), this holding does not impose on the Commission the kind of judgment it has in the past been unable or unwilling to make. For example, in Engineers Pub. Serv. Co., 12 S.E.C. 41, 60 (1942), the Commission, believing that the estimated increased expenses were overstated, determined the amount which it believed the record would sustain.

(1903); 3 WIGMORE, EVIDENCE §1013 (3d ed. 1940). Further, since the practicality of combined customer billing is a matter requiring expert specialized knowledge as to which an agency with the broad jurisdiction of the Commission cannot fairly be expected to have detailed expertise, the Commission may not disregard the testimony of an accepted expert in the absence of any countervailing evidence. See *Market St. Ry.* v. *Railroad Comm'n,* 324 U.S. 548, 560 (1945); *Cullers* v. *Commissioner,* 237 F.2d 611, 616 (8th Cir. 1956). There was no countervailing evidence here and the Commission has given no reasons beyond what it described as an inadequate explanation of Ebasco's not adopting other alternatives in billing and cost allocations (for which there was no support in the record) instead of those which the Commission considered proper (Pet. 53-55).

CONCLUSION

The Petition for a writ of certiorari should be denied.

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